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In the Supreme Court of the United States

OCTOBER TERM, 1985

IRVING AND CHARLOTTE RADOL, *et al.*,

Petitioners,

vs.

W. BRUCE THOMAS, *et al.*,

Respondents.

On Writ of Certiorari to the
United States Court of Appeals for the
Sixth Circuit

PETITIONERS' REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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Petitioners submit this Reply Brief in Support of Petition for Writ of Certiorari in order to reply to certain contentions by respondents in their Brief for Respondents in Opposition (the "Respondents' Brief"), dated January 15, 1986.

1. Respondents Concede that the Third Circuit's *Flynn* Standard of Materiality is Inconsistent with the "Substantial Certainty" Standard Applied by the Sixth Circuit below.

The district court's charge told the jury that a failure to disclose a projection of future earnings can never be a vio-

lation of Rule 10b-5. The Sixth Circuit agreed and ruled that therefore a directed verdict for respondents should have been entered.

Respondents acknowledge that this *per se* rule is incompatible with *Flynn v. Bass Brothers Enterprises, Inc.*, 744 F.2d 978 (3d Cir. 1984). Respondents' Brief, pp. 19 ("multi-faceted 'test' "), 20 ("modified test"), 21 ("multi-factor approach").

Respondents seek to dissipate the force of this conflict by claiming that the decision in *Flynn* "would not be applied to the 1981 events in this case, even in the Third Circuit." Respondents' Brief, pp. 3, 19, 14. This argument is plainly incorrect. Moreover, it disregards the manifest purpose of certiorari, to avoid for the future the clash of inconsistent standards of federal law among the circuits.

In fact, the Third Circuit stated that its "reluctance to apply the new standard for disclosure retroactively *is confined to the facts of this case*." 744 F.2d at 988, n. 19 (italics supplied). This reluctance was due in no small measure to the 8½ year interval from the March, 1976 tender offer to the September, 1984 appellate decision. Indeed, the court felt "constrained by the significant development in disclosure law since 1976 not to apply the announced standard retroactively. . . ." 744 F.2d at 988.

Yet the Third Circuit made abundantly clear that it did "not intend to imply that in other cases based on actions occurring before the date of this opinion, the new standard is necessarily inapplicable." 744 F.2d at 988, n. 19.

There is good reason to believe that, in *this* case, the Third Circuit would have applied *Flynn* and would have found the jury charge to be error. This is particularly so because the district court opinion denying summary judgment to defendants in *Flynn* was published two years before the U.S. Steel tender offer in late 1981. *Flynn v. Bass Brothers Enterprises, Inc.*, 456 F.Supp. 484, 489-493 (E.D. Pa. 1978). The court there held that disclosure of asset appraisals could be material under this Court's decision in *TSC Industries, Inc.*

v. Northway, Inc., 426 U.S. 438 (1976).[1] Therefore, defendants were on notice that asset appraisals could be material well before the tender offer in this case. The Third Circuit standard in *Flynn* would thus apply to this case.

In any event, whether *Flynn* would generally apply prospectively only or retrospectively as well, respondents do not deny that there is a conflict in approaches between the Third and Sixth Circuits. It is the office of the Court's certiorari jurisdiction to review a case such as this because of the decision's likely aid in resolving a single, national standard (Rule 17.1(a)), particularly on a question of federal law which has been decided in a way in conflict with applicable decisions of this Court (Rule 17.1(c)).

2. The Sixth Circuit's *Per Se* Determination that Projections Can Never be Material is Inconsistent with *TSC*.

In *TSC*, this Court held that materiality is a mixed question of law and fact. 426 U.S. at 450. Its determination requires a delicate assessment of inferences best left to the trier of facts. *Id.* By holding that projections of future income and similar projections[2] can never be material under the Federal Securities Laws, the district court and the Sixth Circuit improperly ousted the jury from making the delicate assessment of materiality in this case. The jury below was instructed, *inter alia*, that "[r]epresentations concerning future sales, projections, forecasts, and the like, only rise to the level of materiality when they can be calculated with substantial certainty," that "[e]conomic forecasts are not" required to be disclosed, and that a "failure to make known a projection of future income is not a violation of Rule 10b-5." These state-

1. This was so even if the disclosure included a disclaimer of the appraisals' accuracy or reliability. 456 F.Supp. at 490, 493.

2. The valuations of an oil company's reserves are, as respondents explain, based on a discounted, present value calculation of expected future net revenues to be derived if and when the reserves are pumped out of the ground.

ments foreclose a jury from deciding whether a reasonable investor would view the undisclosed information "as having significantly altered the 'total mix' of information made available." *TSC*, 426 U.S. at 449. The jury below was thus not properly instructed concerning the law.

3. The First Boston Report was *Not* a Selling Document, but in any Event, That and Other Factual Disputes are to be Decided by a Properly Charged Jury.

Respondents' Brief improperly distorts the facts and misleads the Court concerning the differing natures of the two reports at issue.[3]

Respondents assert that the First Boston Report was a selling document. Respondents' Brief, pp. 6, 8, 12. There is no evidence to that effect; to the contrary, the only evidence is that the First Boston Report was prepared to show what an outsider, committing millions of dollars to the research, could glean about Marathon's assets from a careful review and analysis of a multitude of obscure public filings in many states.

As to the in-house Strong Report, by contrast, there was conflicting evidence. Petitioners showed at trial that Marathon employees were instructed to give corporate management their best assessment of the company's actual asset values. Respondents tried to show that top management intended to use the Strong Report, once prepared, as a "selling document."

Respondents' Brief presents the facts in the light most favorable to them. In so doing, respondents begin discussion of certain similarities between the two reports. *See, e.g.*, Respondents' Brief, pp. 6-8. Their continued discussion of only the Strong Report without clear demarcation between it and the First Boston Report is apparently calculated to mislead the reader into assuming that both reports are being discussed when, in truth, the argument pertains only to one. *E.g.*, Respondents' Brief, pp. 8-9. Then the discussion purports to

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3. Respondents did the same thing in their briefs to the Sixth Circuit.

relate to "the Reports" (Respondents' Brief, p. 9) followed by specification only of the Strong Report. *Id.*

Actually, though the Reports reached similar results, they did so by different approaches. Yet, Respondents' Brief misleadingly fails to distinguish between them. In reviewing this case in its present posture, where the facts are genuinely disputed by the parties, this Court should leave to a properly instructed jury the ultimate finding of facts. *TSC, supra.* Moreover, because the Sixth Circuit has upheld the judgment as a directed verdict, the Court is required to view the evidence in the light most favorable to petitioners, the plaintiffs in the district court. *Continental Ore Co. v. Union Carbide Corp.*, 370 U.S. 690, 700-701 (1962) (directed verdict ordered by court of appeals was error; remanded for new trial). It is for a jury, when properly instructed, to weigh contradictory evidence and inferences and to draw the ultimate conclusions as to the facts. *Id.*

In essence, respondents' presentation of the facts is an argument to be made to the jury. The present petition, however, seeks to obtain a new trial in which that jury is correctly charged before resolving the numerous factual disputes.

4. Disclosure of the Strong and First Boston Reports Was Permitted, Not Prohibited, by the SEC.

Respondents argue, in essence, that SEC regulations prohibited the disclosures petitioners demand. The argument is without merit. Worse yet, it turns the Federal Securities Laws on their head.

First, the SEC has determined that asset appraisals (including the very Reports at issue here) are presumptively material in a going-private merger and therefore were required to be disclosed in the February, 1982 proxy statement-prospectus. SEC Rule 13e-3, 17 C.F.R. §240.13e-3. This was the second step of respondents' two-step unitary transaction, after U.S. Steel had already acquired a majority interest in Marathon by use of the tender offer mechanism. Nevertheless, respondents contend that the very same asset appraisals

can *never* be material, as a matter of law, in the first step, the tender offer stage, when the shareholders actually had to decide whether to sell that majority interest to U.S. Steel. This argument is illogical.

The presentation asserts that the materiality of these Reports in the tender offer context must, under *TSC*, be decided on a case-by-case basis and not, as the courts below held, as a matter of law.

Second, respondents ignore the facts in the record that the SEC staff *in fact* permitted the disclosure of estimates of oil and gas reserves other than "proven" reserves. Respondents never sought to introduce any evidence disputing this actual SEC practice. It is reflected in the SEC's official publication. Petition for Writ of Certiorari, at p. A-65.

Third, in this case the respondents knew at the time of the tender offer—and so stated in the offering circular—that a merger vote necessitating the issuance of the proxy statement would be the second stage of their "unitary transaction." Thus, it is reasonable to impose upon them at the tender offer stage the obligation of disclosure under Rule 10b-5 which in any event the SEC considered essential in a merger context. Clearly, the SEC staff would have permitted respondents to make the disclosure at the tender offer stage, since it was going to be made in any event three months later. But neither U.S. Steel nor Marathon sought such permission.

The force of respondents' argument is that they have converted the Federal Securities Laws and SEC regulations designed to protect the *buying* public, into a shield immunizing Marathon and U.S. Steel from disclosing to *selling* investors the most essential information about the value of what they were selling, when U.S. Steel, the buyer, was fully aware of that information. See *Flynn*, 744 F.2d at 987. The policy of the Securities Laws favors full disclosure of such information.[4]

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4. Particularly is this so here. Marathon first told its stockholders to reject the Mobil tender offer because it "does not represent the real values of the assets underlying your investment in Marathon" (boldface deleted) and

5. Projections into the Future are Frequently Employed, Even by the Courts, and Such Use is Reasonable and Material.

The crux of the Sixth Circuit's constriction of the materiality standard announced by this Court in *TSC* is that the circuit court does not believe it "reasonable" for investors to take informed projections into account in making investment decisions. This view, of course, conflicts with the very essence of an investment, which is a future oriented action. Worse, yet, in applying its "substantial certainty" standard to investments, the Sixth Circuit ignored the reality that the courts, like other human institutions, regularly take projections of the future into account.

For example, lost future income is frequently calculated by courts and awarded as non-speculative damages. In *Jones & Laughlin Steel Corp. v. Pfeifer*, 462 U.S. 523 (1983), the Court acknowledged that damages for impaired earning capacity are awarded where "it is assumed that if the injured party had not been disabled, he would have continued to work, and to receive wages at periodic intervals until retirement, disability, or death." 462 U.S. at 533. The damage award "is intended to compensate the worker for the diminution in that stream of income" even though "[t]he lost stream's length cannot be known with certainty. . . ." *Id.* Indeed, although "[t]he probability that [the worker] would still be working at a given date is constantly diminishing" (*id.*), that fact does not preclude a reasonable calculation of lost future income. The courts do not require "substantial certainty" from the expert witnesses who testify about a non-speculative "estimate of what the lost [future] stream of income would have been." 462 U.S. at 536. Nor do courts hold, as did the Sixth Circuit in this case, that economic forecasts can never be material and hence employed.

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because it is an "attempt to seize control of Marathon's assets at a fraction of their value." Then, Marathon recommended acceptance of the competing U.S. Steel tender offer. But, throughout these communications, Marathon never disclosed the information it had as to what the value of the company's assets really was.

These estimates of future events are no less important or material to the outcome of a case merely because we cannot predicate the future with complete accuracy. A "substantial certainty" standard as developed in the Sixth Circuit would, if applied to calculations of future income streams in injury cases, preclude all evidence this Court clearly considered in *Pfeifer* to be essential.

The Court has also observed, in affirming an award of lost future profits, that "every appraisal of damage involving the present value of property involves a predication as to what will occur in the future." *Palmer v. Connecticut R. & Light Co.*, 311 U.S. 544, 559 (1941). The Court there acknowledged it had approved a damage award for lost profits "because 'what is required is not mathematical exactness but only a reasonable approximation. That, after all, is a matter of judgment. . . .'" 311 U.S. at 561.[5]

In a recent decision not yet officially reported, the Ohio Court of Appeals ruled, in the appraisal proceedings arising out of the very tender offer-merger transaction at issue here, that the evidence of net asset value of Marathon was admissible bearing upon the true cash value of all of the shares of the company. The court further found that the evidence indicated that the intrinsic value of Marathon stock at the time of the going-private merger was $163 per share. *Price v. Marathon Oil Company*, Nos. 5-84-4/9 (Ohio Ct. of App., 3d Dist., Jan. 14, 1986).

The jury in this case should have been permitted to consider whether such valuation as contained in the Strong and First Boston Reports was material to the investors' evaluation of the tender offer and going private merger.

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5. Of course, other courts have permitted damage awards based on estimates of future profit or income streams. *E.g., G.M. Brod & Co., Inc. v. U. S. Home Corp.*, 759 F.2d 1526 (11th Cir. 1985) (tortious interference with business relations); *Litton Systems, Inc. v. American Tel. & Tel. Co.*, 700 F.2d 785 (2d Cir. 1983) (antitrust); *Autowest, Inc. v. Peugeot, Inc.*, 434 F.2d 556 (2d Cir. 1970) (Automobile Dealers' Day in Court Act).

CONCLUSION

For all the foregoing reasons and those previously set forth in the Petition for Writ of Certiorari, the Petition should be granted and the case set for full briefing on the merits.

Respectfully submitted,

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February 7, 1986

CERTIFICATE OF SERVICE

I, David H. Weinstein, hereby certify that I am a member of the Bar of the Court, that I am one of the attorneys for petitioners on the foregoing brief, and that three copies of the foregoing brief were served on counsel for each respondent by United States mail this date by deposit of same in a United States post office or mail box, first class postage prepaid, addressed to counsel of record at their respective office addresses.

DATED: February 7, 1986 DAVID H. WEINSTEIN